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No. 00-1564

In the Supreme Court of the United States

JEFFREY N. MEHLER AND MARY S. RUSSELL,

Petitioners,

v.

THE TERMINIX INTERNATIONAL COMPANY, L.P.,

Respondent.

On Petition for a Writ of Certiorari
to the United States Court of Appeals
for the Second Circuit

MOTION FOR LEAVE TO FILE BRIEF AMICI CURIAE AND BRIEF AMICI CURIAE OF PROFESSOR ROBERT A. HILLMAN AND RISA MISH, CORNELL LAW SCHOOL, IN SUPPORT OF THE PETITION FOR CERTIORARI

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QUESTION PRESENTED

Whether the Second Circuit erred in holding that a consumer arbitration agreement governed by the Federal Arbitration Act that imposes an undisclosed $7,000 filing fee is enforceable where a conclusion that it is unenforceable is dictated by generally applicable principles of state contract law.

MOTION FOR LEAVE TO FILE ATTACHED BRIEF AMICI CURIAE

Robert A. Hillman, Edwin Woodruff Professor of Law at Cornell Law School, and Risa Mish, also of Cornell Law School, move for leave to file the attached brief *amici curiae* in support of the petition in this case. Petitioners consented to the filing of this brief. Respondent refused to consent to its filing, without explanation, making this motion necessary.

Robert A. Hillman is the Edwin Woodruff Professor of Law at Cornell Law School, concentrating on contract and commercial law over his twenty-six year teaching career. Professor Hillman has authored or co-authored five books and over forty articles on contracts and commercial law. Prior to teaching, Professor Hillman clerked for two federal judges and practiced law with the firm of Debevoise & Plimpton in New York City. Through his extensive research and legal writings on contract law and commercial law, and his teaching, Professor Hillman has dedicated himself to advancing the public's understanding of contract law. Risa Mish is director of Alumni Relations at Cornell Law School. She was formerly a partner at Collazo Carling & Mish LLP in New York City, where she represented corporations on issues that included breach of contract claims. Prior to that she clerked for a federal judge and practiced at Simpson Thacher & Bartlett in New York City. As members of the legal education community, *Amici* are dedicated to teaching the importance of upholding the rule of law under the U.S. Constitution, generally, and to teaching the importance of the role of general principles of contract law to

our system of justice. Neither *Amici* is affiliated directly, or indirectly, with Petitioners.

By filing this brief, *Amici* wish to emphasize that the issues presented in this case are not limited to the facts at issue here but are of widespread importance to all parties who sign standard-form contracts. The unconscionability issue raised by Petitioners implicates the most fundamental principles of contract law applicable to determining a contract's enforceability. If courts operating under the Federal Arbitration Act may ignore these principles, as happened here, such decisions will lead toward the diminution of the rule of law and the protections it affords contracting parties such as Petitioners. Consumers, who are likely targets of oppressive arbitration clauses, have no protection against such terms except as exist under general principles of contract law. We wish to bring this broader perspective to bear on the Court's consideration of the case. Accordingly, *Amici* seek leave to file this brief *amici curiae*.

Respectfully submitted,

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Date: May 11, 2001

TABLE OF CONTENTS

	Page
INTEREST OF AMICI CURIAE	1
STATEMENT OF THE CASE	1
SUMMARY OF ARGUMENT	1
ARGUMENT	3
A. Unconscionability	6
B. Restatement (Second) Section 211(3)	8
C. Doctrine of Reasonable Expectations	8
CONCLUSION	9

TABLE OF AUTHORITIES

Page

CASES

Brower v. Gateway 2000, Inc., 676 N.Y.S.2d 569 (A.D. 1998) 7

C & J Fertilizer, Inc. v. Allied Mutual Ins. Co., 227 N.W.2d 169 (Iowa 1975) 9

Doctor's Assocs., Inc. v. Casarotto, 517 U.S. 681 (1996) 3

Green Tree Fin. Corp. v. Randolph, 531 U.S. 79 (2000) 7

M.A. Mortenson Co., Inc. v. Timberline Software Corp., 998 P.2d 305 (Wash. 2000) 6, 7

Mastrobuono v. Shearson Lehman Hutton, Inc., 514 U.S. 52 (1995) 3

Mehler v. The Terminix Int'l Co., 1998 WL 893149 (D. Conn. 1998) 2

Myers v. Terminix Int'l Co., 697 N.E.2d 277 (Court Comm. Pleas of Ohio. 1998) 7

Nelson v. McGoldrick, 896 P.2d 1258 (Wash. 1995) ...6, 7

Rodman v. State Farm Mut. Ins. Co., 208 N.W.2d 903 (Iowa 1973) 9

Waters v. Min. Ltd., 587 N.E.2d 231 (Mass. 1992)..... 6

TABLE OF AUTHORITIES – Continued

Page

CONSTITUTIONAL AND STATUTORY PROVISIONS

9 U.S.C. § 2 3

U.C.C. § 2-302, cmt. 1 6

TREATISES

Proposed Amendments to Uniform Commercial Code Article 2 – Sales, American Law Institute Draft, Section 2-302, Preliminary Comment 1 (May 2001) 5

RESTATEMENT (SECOND) OF CONTRACTS (1979) 2, 3, 8

OTHER

E. A. Farnsworth, CONTRACTS, § 4.26 (3d ed. 1999) 4

Friedrich Kessler, *Contracts of Adhesion – Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629 (1943) 4

INTEREST OF AMICI CURIAE[1]

Amici rely on the statement of its interest set forth in its attached Motion for Leave to File Brief *Amici Curiae*.

STATEMENT OF THE CASE

Amici rely on the Statement set forth in the Petition for a Writ of Certiorari.

SUMMARY OF ARGUMENT

This Court should reverse the Second Circuit's decision here because, contrary to the express requirement of the Federal Arbitration Act ("FAA"), the court failed to apply long standing principles of state contract law that dictate nonenforcement of the arbitration clause at issue. Allowing the decision to stand may lead courts to adopt similar improper approaches that diminish the role of state contract law under the FAA and would maintain the split among the circuit courts created by the Second Circuit's decision on unconscionability here.

This Court has made clear that Congress expressly preserved the applicability of general principles of state

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[1] In conformity with Supreme Court Rule 37, *Amici* state that counsel for Petitioner did not author the body of this brief but did prepare the Table of Authorities, Motion for Leave to File and cover pages and provided minor editorial comments. No persons or entities made a monetary contribution to the preparation and submission of the brief other than for printing costs, which were paid by Petitioners.

contract law under the FAA. The Court has determined that in enacting the FAA Congress's purpose was to require courts to enforce the terms of the parties' agreements. The FAA expressly refers to the applicability of contract law principles that would render an agreement to arbitrate unenforceable.

In Petitioners' case, the United States Court of Appeals for the Second Circuit failed to consider or apply three of the most basic principles of contract law governing a contract's enforceability: unconscionability; the rule established in Section 211(3) of the SECOND RESTATEMENT OF CONTRACTS; and the doctrine of reasonable expectations.

Even if the Second Circuit correctly determined that a contract with an agreement to arbitrate governed the initial treatment (a conclusion with which *Amici* disagree),[2] the three principles of contract law discussed in this brief dictate that the contract should not be enforced. *Amici* respectfully request that this Court reverse the Second Circuit as to the issue of unconscionabilty because

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[2] *Amici* disagree with the Second Circuit's holding that the arbitration clause applies to this dispute for the reason that the contract containing the arbitration clause "became effective" after the initial treatment that caused Petitioners' damages. *Amici* agree with the opinion of District Judge Thompson in this case. *Mehler v. The Terminix Int'l Co.*, 1998 WL 893149 (D. Conn. 1998). *Amici* also agree with Petitioners that the Second Circuit's approach effects an unauthorized preemption of state contract law; however, both the scope of the contract and preemption have been well-briefed by Petitioners and the latter issue is beyond *Amici's* specific expertise. This brief focuses on the issue of unconscionability. The discussion assumes that the Terminix arbitration clause applies to the events at issue simply for the purpose of this analysis.

it is at odds with the express directives of the FAA and contract law.

ARGUMENT

The Federal Arbitration Act enforces "private agreements to arbitrate." *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 54 (1995). The Act therefore presupposes an enforceable "agreement" between the parties to arbitrate and allows challenges to arbitrability based "upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. Principles of state law thus determine the "validity" of arbitration provisions. *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681 (1996). Based on three long-standing principles of state contract law – unconscionability, Section 211(3) of the Second Restatement of Contracts, and the doctrine of reasonable expectations – the arbitration clause here is unenforceable because the Mehlers never consented to arbitrate this dispute.

The Terminix "agreement" to arbitrate is contained within a form contract that is a classical contract of adhesion. Signing it involved a face-to-face meeting at the customer's home between an agent of Terminix and the Mehlers. The printed form presented to the Mehlers contains a few basic terms to be filled in by the parties, with the rest, including the arbitration provision, pre-printed by Terminix. In preparing the form, Terminix clearly planned to use it repeatedly and therefore invested time and money in preparing it. Customers such as the Mehlers have no familiarity with forms used in a one-

time transaction. They reasonably understand that the agent could not and would not bargain over the form's pre-printed terms, including a pre-printed arbitration clause. In the Mehlers' case, they were unable to secure any other service and therefore had no alternative but to contract with Terminix. A customer who is asked to sign at his home a one page form contract for home services generally understands that the likelihood of a dispute is small and would not dream of the consequences that developed in this case. Customers weighing costs and benefits would reasonably conclude that the cost of engaging the professional services necessary to understand all of the implications of the home service form contract outweigh any benefits of doing so and would sign the form without comprehending the implications of the Terminix arbitration clause in the contract here.

Although standard form transactions such as this do not involve the back-and-forth bargaining envisioned by classical contract law, *Amici* do not contest the general enforceability of standard form contracts. Form contracts are widely used precisely because they provide significant savings to the provider of the form and possibly savings to the consumer. In brief, form providers standardize their risks and reduce bargaining costs by offering one set of terms to all users. *See* Friedrich Kessler, *Contracts of Adhesion – Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629, 631-32 (1943); E. A. Farnsworth, CONTRACTS, § 4.26, at 296 (3d ed. 1999) ("because a judicial interpretation of one standard form serves as an interpretation of similar forms, standardization facilitates the accumulation of experience").

Providers may pass on some of the savings to consumers by lowering prices for the goods or services.

In light of the benefits of standard forms, courts generally and correctly enforce them. Nevertheless, the analysis cannot end here as it did with the Second Circuit's decision. Courts applying general principles of contract law must also focus on the potential for the form provider to include objectionable terms precisely because of the dynamics of standard-form transactions – the reasonable failure of the user to read the form, the lack of an opportunity to bargain over terms, the absence of reasonable alternatives for the consumer, etc. Applying state contract law, courts have readily stepped in when the form provider goes too far. In fact, the drafters of the revised Article 2 of the Uniform Commercial Code recently noted that "courts have been particularly vigilant when the contract at issue is set forth in a standard form." Proposed Amendments to Uniform Commercial Code Article 2 – Sales, American Law Institute Draft, Section 2-302, Preliminary Comment 1 (May 2001).

In sum, current state contract law creates a presumption of assent to negotiated terms and *reasonable* standard terms, with courts empowered to strike unreasonable or unfair clauses. Courts base their decision to strike a provision on one or more of the following three doctrines, the application of any one of which would render the arbitration agreement in this case unenforceable.

A. Unconscionability

Under the long-established unconscionability doctrine, courts strike contracts or terms in order to prevent "oppression and unfair surprise." *See, e.g.*, U.C.C. § 2-302, cmt. 1; *Waters v. Min. Ltd.*, 587 N.E.2d 231 (Mass. 1992). The doctrine allows courts to police unfair terms directly rather than covertly by manipulating other rules such as misrepresentation or duress. Generally, courts investigate the manner in which the parties entered the contract ("procedural unconscionability") and weigh the fairness of the resulting substantive terms ("substantive unconscionability").

Procedural unconscionability consists of a " 'lack of a meaningful choice, considering all the circumstances surrounding the transaction' including 'the manner in which the contract was entered,' whether each party had 'a reasonable opportunity to understand the terms of the contract,' and whether 'the important terms [were] hidden in a maze of fine print. . . . ' " *M.A. Mortenson Co., Inc. v. Timberline Software Corp.*, 998 P.2d 305, 325 (Wash. 2000) (*quoting Nelson v. McGoldrick*, 896 P.2d 1258 (Wash. 1995)). Because Terminix's agent presented the Mehlers with a take-it-or-leave-it preprinted form contract that did not reveal the costs or details of arbitration, but only incorporated the "Commercial Arbitration Rules" of the American Arbitration Association, the Mehlers never had a reasonable opportunity to understand the ramifications of agreeing to arbitrate, including the duty to pay a fee of $7,000 and additional expenses. The arbitration agreement was therefore procedurally unconscionable.

Substantive unconscionability encompasses terms that are manifestly unjust, "one-sided or overly harsh." *M.A. Mortenson*, 998 P.2d at 323 (*quoting Nelson*, 896 P.2d 1258). For example, a clause is unconscionable when it conflicts with public policy, denies a party substantially what she bargained for, or has no reasonable purpose. In one recent case, for example, a court found substantively unconscionable a mandatory arbitration provision and stated, "Barred from resorting to the courts by the arbitration clause in the first instance, the designation of a financially prohibitive forum effectively bars consumers from this forum as well; consumers are thus left with no forum at all in which to resolve a dispute." *Brower v. Gateway 2000, Inc.*, 676 N.Y.S.2d 569, 573 (A.D. 1998).

Here, Terminix's mandatory arbitration provision was substantively unconscionable because, by incorporating by reference the Rules of Commercial Arbitration of the American Arbitration Association, the provision would require the Mehlers to pay a $7,000 filing fee that effectively denies the Mehlers an opportunity to air their grievances concerning the catastrophic harm they have suffered. Generally, such strategies by form providers can only discourage consumers from pursuing their state law rights when form providers breach their contracts. In fact, other courts have already recognized the unconscionability of Terminix's arbitration clause. *Myers v. Terminix Int'l Co.*, 697 N.E.2d 277 (Court. Comm. Pleas of Ohio, 1998). This Court has also recognized that "large arbitration costs [can] preclude a litigant . . . from effectively vindicating . . . rights in the arbitral forum." *Green Tree Fin. Corp. v. Randolph*, 531 U.S. 79 (2000).

B. Restatement (Second) Section 211(3)

Section 211(1) of the Second Restatement of Contracts memorializes the traditional duty-to-read standard of contract law. *See* RESTATEMENT (SECOND) OF CONTRACTS § 211(1) (1979) ("where a party to an agreement signs or otherwise manifests assent to a writing, he adopts the writing as an integrated agreement with respect to the terms included in the writing"). In dismissing without discussion the Mehlers' unconscionability claim, the Second Circuit adhered to the duty-to-read principle without considering the substantial body of doctrine represented by Section 211(3): "Where the [form provider] has reason to believe that the party manifesting such assent would not do so if he knew that the writing contained a particular term, the term is not part of the agreement." Applying Section 211(3) to the Terminix-Mehler contract, the issue is whether Terminix should reasonably have comprehended that the Mehlers would not have agreed to arbitration had they understood that they would have to pay a fee of $7,000 before any of their grievances relating to a catastrophic breach by Terminix would be aired. The answer is clearly that Terminix reasonably should have understood that the Mehlers would not have agreed to arbitrate under such conditions. The arbitration provision is therefore unenforceable under Section 211(3).

C. The Doctrine of Reasonable Expectations

The reasonable expectations doctrine, most prominent in insurance form-contract cases, but not limited to them, holds that

> [t]he objectively reasonable expectations of applicants and intended beneficiaries regarding the terms of insurance contracts will be honored even though painstaking study of the policy provisions would have negated those expectations.

C & J Fertilizer, Inc. v. Allied Mut. Ins. Co., 227 N.W.2d 169, 176 (Iowa 1975) (*quoting Rodman v. State Farm Mut. Ins. Co.*, 208 N.W.2d 903, 906 (Iowa 1973)).

The doctrine is easily transferable to other types of standard forms, including the Mehler-Terminix contract. The principle authorizes courts to overturn express contract language if the term contradicts the form user's reasonable expectations. The doctrine therefore creates an affirmative duty on the part of the form provider to point out and explain reasonably unexpected terms even if they are stated in the contract. The doctrine reflects the reality that form users do not read their contracts and that they agree to be bound only to reasonable boilerplate. Applied here, the question is whether the Mehlers reasonably expected to have to pay $7,000 and other expenses in order to arbitrate a dispute over Terminix's calamitous negligence. Without any forewarning from Terminix concerning the ramifications of agreeing to arbitration, there is no reason why the Mehlers should have expected such an unfair result.

CONCLUSION

General principles of state contract law provide an excellent, workable solution to the problem of policing unbargained-for standard form contracts and to the

issues raised here. The law presumes the general enforceability of standard forms, but it negates terms procured unfairly or that are reasonably unexpected because unjust or indecent. By enforcing the arbitration provision here, where the consequences of agreeing to arbitration were reasonably unexpected and unreasonable, the Second Circuit violated both the FAA's directive to apply state contract law as well as the outcome dictated by applicable contract principles concerning enforceability. In short, Petitioners never agreed to arbitrate on the contract's terms. The Second Circuit's decision should be reversed.

Respectfully submitted,

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